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No. 536

In the Supreme Court of the United States

OCTOBER TERM, 1968

JOSEPH REITER AND LEROY GUNTNER, CO-TRUSTEES,
PETITIONERS

v.

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The opinion of the district court (Pet. App. 1a–8a) is unreported. The opinion of the court of appeals (Pet. App. 9a–19a) is reported at 396 F. 2d 407.

JURISDICTION

The judgment of the court of appeals was entered on June 7, 1968. A petition for rehearing was denied on July 2, 1968. The petition for a writ of certiorari was filed on September 18, 1968. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

325-301—68

QUESTION PRESENTED

Whether the Federal Home Loan Bank Board had authority to require and enforce a "Pledge and Escrow Agreement" covering petitioners' insured savings accounts.

STATEMENT

The First Federal Savings and Loan Association of Morton Grove, Illinois (First Federal), was chartered on August 1, 1959, by the Federal Home Loan Bank Board (Board), an agency of the United States charged with the responsibility of chartering, regulating, and supervising federal savings and loan associations (App. 12; 12 U.S.C. 1464).[1] The Board manages and supervises respondent Federal Savings and Loan Insurance Corporation (FSLIC).

As a condition for the issuance of a charter and for the insurance of the accounts of First Federal, the Board required the execution of a "Pledge and Escrow" agreement by the promoters and organizers of First Federal and several of their business associates covering savings deposits in the aggregate amount of $50,000 (App. 27, 32, 62, 65–67).[2] The savings share accounts were to be held in escrow by the Federal Home Loan Bank in Chicago as a pledge and guarantee to First Federal against losses. The agreement provided that whenever the Board found an impairment in the capital of First Federal or any deficit in any accounting period, the Board might direct the

[1] "App." refers to appellant's appendix in the court of appeals.

[2] Seven of the pledgors, including petitioners, became directors and officers of First Federal.

Chicago Home Loan Bank to deliver the pledged share accounts to First Federal for cancellation and for transfer of the deposits to First Federal's reserves for the purpose of absorbing losses (App. 64).[3] It further provided that if any charges against the pledged share accounts had been made, First Federal was to refund such amounts, whenever possible after the termination of the Agreement on August 1, 1964, provided such refund would not reduce the net reserves of First Federal to less than three per cent of its net assets.

In May 1964, the directors of First Federal advised the Board that First Federal had suffered a deficit in its current accounting period and that it anticipated sizeable future losses (App. 68).[4] On June 8, 1964, the directors consented to the appointment of a conservator, and on June 15, the Board appointed a conservator to take charge of First Federal on June 27.

In anticipation of the Board's enforcement of the Pledge Agreement, the directors of First Federal, on June 18, authorized petitioners Reiter and Guntner (president and secretary, respectively, of First Fed-

[3] The agreement also provided that the pledged share accounts might also be delivered for cancellation and transfer for the purpose of absorbing losses in the event of First Federal's liquidation.

[4] The directors admitted that First Federal would be deficient $47,000.00 of the amount necessary to pay a current dividend on savings accounts (App. 68). They also conceded potential losses of $174,000.00 on bad loans as against reserves of only $72,000.00. They sought the Board's permission to use escrow funds to meet current dividend requirements and offered to replace such escrow funds with sufficient further money to meet one-half of the potential losses.

eral) to withdraw the funds represented by the pledged accounts and to hold the funds as co-trustees for the pledgors (App. 32). Although the passbooks for the pledged accounts were still held by the Chicago Loan Bank, petitioners drew a check for $50,000 on the general funds of First Federal, and the money ultimately was deposited in their trustee account in the National Boulevard Bank (App. 32–33, 81; Pet. App. 11a–12a, 14a).

On June 22, the Board, pursuant to the Pledge Agreement, directed the Chicago Loan Bank to deliver the pledged share accounts to First Federal for cancellation and for transfer of the deposits to its reserves (App. 33, 34). The conservator carried out the cancellation and transfer instructions when he took charge of First Federal.

On June 27, when the conservator took charge of First Federal, he entered into a merger agreement with Second Federal Savings and Loan Association (Second Federal), a successful institution which was to be the surviving association (App. 36–40). In order to facilitate the merger, respondent FSLIC agreed to purchase, for $2,800,000, various distressed and doubtful assets of First Federal and to assume all its undisclosed liabilities (App. 41–46, 81); this agreement was incorporated by reference in the merger agreement (App. 39). All other assets of First Federal, including its rights in the funds withdrawn by petitioners under the Pledge Agreement, were transferred to Second Federal (App. 38–39). Second Federal thereafter assigned, for full consideration, all of its rights in the funds to respondent FSLIC (App. 47). Upon re-

spondent's demand for return of the money, petitioners initiated the present action for a declaratory judgment of their right to retain the funds (App. 2–5).

The district court, construing the terms of the Pledge Agreement, held that petitioners had a right to retain the $50,000 which they had withdrawn from First Federal (Pet. App. 1a–8a). The court reasoned that since a refund of $50,000 would not reduce the net reserves of Second Federal below three percent of its net assets, Second Federal—and therefore its assignee, respondent FSLIC—could not recover the $50,000 because it was obligated under the Pledge Agreement (as the successor to First Federal) to refund that amount to petitioners.

The court of appeals, however, rejected the district court's reasoning and held that Second Federal's ability to make a refund did not entitle petitioners to retain the $50,000 which they had illegally withdrawn from First Federal because petitioners had no right to a refund from Second Federal (Pet. App. 15a–16a). The court held that petitioners' rights under the refund clause in the Agreement were conditioned on First Federal's acquisition by its own operations of adequate capital reserves, which it failed to do, and that petitioners obtained no greater rights where First Federal was merged into Second Federal in order to prevent default and where the respondent had to purchase $2,800,000 of doubtful assets of First Federal. As the court of appeals observed (Pet. App. 15a):

> There was no longer a First Federal as contemplated by the refund clause in question. In our view, the refund clause was not meant to

> apply after the failure of First Federal but required the continuation of business on its part. Cf. International Co. of St. Louis v. Sloan, 114 F. 2d 326, 329 (C.A. 10, certiorari denied, 311 U.S. 702) * * *.

The court of appeals also rejected petitioners' argument that the pledge of share accounts as a condition of the grant of a charter was beyond the authority of the Bank Board (Pet. App. 17a).

ARGUMENT

In this Court, petitioners do not raise, as they did below, any issue concerning the interpretation of the Pledge and Escrow Agreement.[5] Rather, they argue that the Board had no authority to require petitioners to enter into the agreement as a condition of the issuance of a charter and that respondent FSLIC's attempt to recover the $50,000 is inconsistent with its statutory duty to insure the pledged share accounts.

1. Section 5(e) of the Home Owners' Loan Act, 12 U.S.C. 1464(e), provides that no charter shall be granted unless there is a reasonable probability of an association's success. Section 403 of the National Housing Act, 12 U.S.C. 1726, requires the Federal Savings and Loan Insurance Corporation to obtain an agreement from an insured association to provide and maintain "adequate reserves satisfactory to the Corporation" (12 U.S.C. 1726(b)). By the Pledge and Escrow

[5] The form of the "Pledge and Escrow Agreement" has been modified substantially since this case arose to include a provision covering supervisory merger, bulk sale of assets and other measures used by the Federal Savings and Loan Insurance Corporation to prevent defaults.

Agreement, petitioners—who were First Federal's promoters, organizers, managers, and their business associates—provided a guarantee of "equity" capital to absorb losses until the association's earnings were sufficient to accumulate the "adequate reserves" required by Section 403 of the Housing Act.

In view of the Board's statutory duty to require that a federally insured association have a reasonable probability of success, that it not have an impairment of capital, and that it maintain adequate reserves, the Board had the authority to require the Pledge Agreement. The pledge of petitioners' share accounts was an appropriate and recognized method of assuring the solvency of the association during its initial years[*] and was within the broad discretion which the Board has with respect to the issuance of charters. See *Federal Home Loan Bank Board* v. *Rowe,* 284 F. 2d 274 (C.A.D.C.).

Petitioners also contend that former Rule 543.2(d)(3) of the Board's Rules (Pet. App. 20a) limited guarantees imposed as conditions by the Board to "organization and operating expenses." The court of appeals correctly held, however, that the condition of a guarantee against losses during the association's growth period was authorized by subsection (4) of the same Rule, which permits the Board to establish "such other requirements as it deems necessary or desirable" (Pet. App. 17a, 20a). The limitation in subsection

[*] Petitioners themselves also recognized this fact and, in their letter of May 4, 1964, making certain recommendations about the association, they offered to pledge an additional $50,000 (App. 70).

(3) does not preclude the requirement of such a guarantee which the Board "deems necessary or desirable" under the circumstances to ensure against the insolvency of the association.[7]

2. Petitioners also contend that the "Statutory Duty of the Federal Savings and Loan Insurance Corporation to reimburse any loss of deposits in this case offsets any claim it may have to the $50,000 in controversy" (Pet. 16). But the Federal Savings and Loan Insurance Corporation is obligated by statute to make payment on an insured account only "in the event of a default by any insured institution" (12 U.S.C. 1728). The fact is that there never was a default in the payment of these accounts.

The share accounts were pledged by petitioners to First Federal as a guarantee against the association's deficits or an impairment of its capital (App. 64). Once the condition of the guarantee took effect (*i.e.*, a deficit or impairment of capital) the share accounts were cancelled "and the dollar amounts of credits represented by such cancelled shares" were transferred to First Federal's reserves. The fact that those accounts were federally insured has no bearing at all

[7] Other Rules of the Board recognize that the pledge of share accounts is often a desirable means to assure financial stability. Rules 556.2(g)(4) and 571.5(g)(4), which outline a policy to be followed by the Board in its actions relating to mergers of savings and loan associations, suggests the following possible alternatives to a proposed merger:

> Providing a larger cushion for operating deficits or losses through a pledge of savings accounts by directors and other members of a mutual institution or a contribution to paid-in surplus by stockholders of a permanent stock institution.

on First Federal's rights in the accounts under the Pledge Agreement. First Federal was not obligated to pay an account cancelled under the Pledge Agreement. It follows that since First Federal was not obligated to pay the cancelled accounts, it could not possibly be in default of payment. Hence, respondent FSLIC was not required to pay an insurance claim on the accounts because such a claim never arose.[8]

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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[8] Petitioners apparently argue that it is impossible for a savings and loan association to have security interests in its own savings accounts (Pet. 17). It is common practice, however, for banks and savings and loan associations to loan money to borrowers on the security of a borrower's savings account with the loaning bank. In fact, the Home Owners' Loan Act, 12 U.S.C. 1464(c), expressly authorizes this practice.

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